

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Alternative Investments -
Market Review

ITEM NUMBER: 9

ATTACHMENT(S): 2

ACTION: _____

DATE OF MEETING: February 5, 2003

INFORMATION: X

PRESENTER(S): Réal Desrochers/McKinsey & Company

Executive Summary

McKinsey & Company was selected as the Alternative Investment Advisor to the Investment Committee in June of 2002. In October McKinsey undertook an eight week in depth study of the program and industry Benchmarking. This report summarizes their findings as well as their review of the private equity investment market.

Objectives of the study were:

- (1) Create a baseline understanding of CalSTRS' historical performance, investment mix, and capabilities.
- (2) Assess CalSTRS' current capabilities, market positioning, and sources of competitive advantage.
- (3) Review performance of CalSTRS' alternative investment strategy against its overall investment objectives, industry outlook, and long-term success requirements for the system.
- (4) Identify potential Investment Committee-level concerns/issues regarding future alternative investment performance.
- (5) Engage in on-going, value-added dialog with staff on potential improvement opportunities and key organizational imperatives for successful execution of alternative investment strategy.

McKinsey & Company, represented by Michael Bender, Beth Cobert and Melissa Ma, will present the findings from this study. McKinsey will continue to work with the staff and its advisors in preparing the semi-annual report for the Investment Committee, which will be presented in March 2003.

The company profile and biographies of attendees are included as Attachment 1 and the "Overview of Alternative Investments for Institutional Investors" report is included as Attachment 2.

MCKINSEY & COMPANY COMPANY PROFILE

ORGANIZATION

McKinsey & Company (McKinsey) is a global management consulting firm. Since our founding over 75 years ago, McKinsey's primary mission has been to help our clients achieve substantial, lasting improvements in their performance. We maintain the highest professional standards by maintaining objectivity and independence, and placing our clients' interests above our own institutional interests. This is our commitment and our passion.

Our more than 1,000 clients worldwide include 100 of the largest 150 global companies, together with a diverse group of governments, institutions, and nonprofit organizations. We develop and maintain deep, specialized business and economic, industry, and functional knowledge, and we collaborate regularly with leading thinkers in business, government, and academia. The cornerstone of our approach is our people. With over 7,600 consultants in 80 offices worldwide, we deliver client impact by leveraging access to this broad-reaching, powerful network of expertise.

We use a comprehensive approach to helping our clients by uniquely combining five critical capabilities.

- ¶ **Industry expertise.** We maintain active, global industry practices in approximately 20 sectors, ranging from high tech, telecommunications, health care and biotechnology, to private equity and financial institutions. Each of these practices pursues independent research on many industry-related topics to ensure our experts provide the latest thinking.
- ¶ **Functional expertise.** In addition to our industry-based practices, we also have active functional practices in approximately 35 areas, such as strategy, organization, corporate finance, and operational effectiveness.
- ¶ **Geographic reach.** We have 85 offices in 44 countries throughout the Americas, Europe, Asia, and the Pacific. Through these offices, we have over 7,500 consultants and approximately 900 partners of 100 different nationalities.
- ¶ **Knowledge transfer.** In order to bring the best to bear for each of our clients, regardless of location or sector, we actively ensure knowledge transfer across our offices and across industries. The Firm is structured in this way to allow us to maximize our value to the client by aggregating and disseminating non-confidential insights gained from previous experiences, developing internal experts and specialists, and continually researching the latest trends and issues in each area. Our ability to leverage our firm knowledge base and expertise for the benefit of our clients is truly unparalleled.

¶ **Consulting approach.** Since our inception in 1926, McKinsey's primary mission has been to help our clients achieve substantial, lasting improvements in their performance. Our tailored, dedicated client teams deliver this impact by utilizing creative problem solving, disciplined fact-based analysis, and an emphasis on implementation.

McKinsey's experience with alternative investments and institutional investors

Our client experiences related to alternative investments are both broad and deep. We serve a diverse group of institutional investors and a long list of general partners and other financial institutions on topics such as alternative investment strategy, organizational and governance structure, due diligence, and investment process design. In the past 5 years we have completed over 700 engagements globally for close to 130 different clients in the alternatives asset class. Approximately 45% of this work was conducted outside North America, consistent with the global nature of our Firm.

Our Firm has supplemented this client experience with in-depth proprietary research on many related topics and strong industry, functional, and geographic expertise. Much of our relevant research is presented in our proposal and includes comprehensive studies on key performance drivers of venture capital, private equity, and distressed debt investments.

Our experience, built from this combination of proprietary research, client engagements, and Firm expertise, provides us with a comprehensive understanding of alternative investments. We will bring the full force of our experiences and multi-dimensional perspective to the proposed advisory work for CalSTRS. Additionally, the Firm is strongly committed to institutional investors investing in alternatives. In the last 2 years, we have completed over 15 engagements for public pensions on alternative investments. In 2001, we also dedicated significant resources to help establish the Institutional Limited Partners Association (ILPA) on a pro-bono basis. We initially helped them design the organization and governance structure of the ILPA, and we continue to be a key advisor to the board.

MCKINSEY & COMPANY

STAFF BIOGRAPHIES

Michael W. Bender

Michael Bender is a Director in the San Francisco Office and has been with McKinsey & Company since 1989. He currently leads McKinsey's West Coast Financial Institutions Practice and has done significant work in retail banking, asset management, life insurance, property and casualty insurance, wholesale banking, and health care payment/provision. Michael is also a co-leader of McKinsey's North American Financial Institutions Information Technology and Operations Practice. Sample recent engagements include:

- Working with the California Employees' Public Retirement System, the largest pension fund and institutional manager in the U.S., to develop a new \$500 million initiative to invest in underdeveloped markets
- Advising a top 20 U.S. public pension fund on the development of its alternative investment strategy and performance of due diligence on potential strategic partnership transactions
- Evaluating the acquisition of a large U.S. multi-line P&C carrier for a U.S.-based investor group
- Developing a long-term mortgage banking strategy – across all functions – utilizing an economic value-added approach for a major U.S. bank
- Redesigning the top-team organization and management processes – e.g., planning/budgeting and people management – for a leading asset manager
- Evaluating the acquisition and growth of a primary care physician organization (“the McDonald's of Primary Care”) for a U.S.-based LBO firm
- Redesigning the top-team organization and management processes, e.g., strategy, setting, planning/budgeting and people management - for a leading asset manager
- Developing a strategy for a major retail asset manager to rapidly grow the institutional asset management market
- Identified potential buyers for a California-based thrift as well as valuation ranges for different buyers

Prior to joining McKinsey, Michael worked with Oliver, Wyman & Company, a New York based consulting firm focused on financial institutions. He holds an M.Phil in Economics from Oxford University, where he studied as a Marshall Scholar, and a B.A. in Economics from Harvard College.

Beth Cobert

Beth Cobert is a Director in McKinsey's San Francisco office. She joined the Firm in 1984 in New York and transferred to San Francisco in 1994. Beth has worked on a variety of strategic and organizational issues in the financial services, asset management and institutional investments arenas. Her most recent assignments include:

- Working with a major institutional asset manager on their investment organization and investing approach to align it with their investment objectives and philosophy
- Assisting a major financial institution to assess their private equity investment approach including both direct investments and structured capital markets products (e.g., loan securitizations, CLOs, etc.)
- Helping several private equity firms assess specific investments-e.g., in the consumer retirement services markets, medical supplies, etc.
- Assisting a major securitizer of mortgage assets develop a risk management approach that addressed the growing size and complexity of their activities
- Working with a major investment bank to reshape their organization structure, governance processes, and people management approaches to fit their increasing focus on securitization and capital markets activities
- Assisting a major professional services firm develop a more effective organizational and strategic approach to drive higher performance

Beth is a leader of the Firm's North American Financial Services and Private Equity practices and heads up McKinsey's Institutional Investor sub-sector. Prior to joining McKinsey, Beth worked for Goldman, Sachs & Co. in their Corporate Finance Department. At Goldman Sachs she worked on a broad array of transactions including mergers and acquisitions, public offerings, and new product development. Beth received her M.B.A. in 1984 from Stanford Business School, where she was an Arjay Miller scholar and now serves on the Stanford Business School Management Council. She also holds a B.A. in Economics, Phi Beta Kappa, from Princeton University.

Melissa J. Ma

Melissa Ma is an Associate Principal in the San Francisco Office of McKinsey & Company. She is currently a leader of McKinsey's Institutional Investor Practice, the West Coast Financial Institutions Practice and the North American Private Equity Practice.

In her role at McKinsey, Melissa has served leading institutional investors and financial institutions on issues of strategy, organization, operations, investments, and corporate finance. Examples of her recent experience include:

- Working with one of the United States' largest pension funds and institutional manager to develop a new \$500 million initiative to invest in underdeveloped markets. She led the feasibility assessment, investment strategy planning, and the execution of the partner selection process
- Helping one of the largest U.S. public pensions develop their investment strategy for the alternatives asset class and perform due diligence on potential strategic partnership transactions
- Leading an effort at a leading North American pension fund to refine their overall private equity strategy, restructure their fund portfolio, and consider innovative partnership and fund options for future investments
- Assisting the membership of a premier investor association to "formalize" their organization. She led the effort to define their mission, board structure, financing plan, by-laws, and membership services
- Leading a yearlong effort to define the vision and corporate strategy for one of California's largest commercial bank. In addition to working with the CEO and top executives to articulate their 3-year corporate strategy, she helped lead a series of teams that developed individual business initiatives across the bank

Before joining McKinsey, Ms. Ma was employed by Goldman, Sachs & Co. in New York. As a member of the Investment Banking division's Financial Institutions Group, she planned and executed financing and merger transactions for international banks, insurance, and finance companies.

Melissa received an M.B.A. with Distinction from Harvard Business School and holds a B.A. in economics and East Asian studies, *magna cum laude*, from Harvard University.

Attachment 2
Investment Committee – Item 9
February 5, 2003

Note: This item is not available in an electronic format.